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Memorandum for:

Attached are contributions for the video briefing requested [] The video is being prepared for President Reagan's upcoming trip to Europe this May.

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Attachments: as stated

7 March 1985

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State Dept. review completed

**EUR A**

**Office of European Analysis
Directorate of Intelligence**

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Bonn Economic Summit -- Theme Issue

An important theme at this year's Summit will be economic restructuring -- in particular looking at the difficulties West European economies are encountering in moving from a smokestack industrial age to one of high-tech, information processing, and services. Around 20 million new jobs have been created in the United States over the past 10 years; in Europe over the same period, no net jobs have been created. With hundreds of thousands of jobs being lost in industries such as steel, shipbuilding, and autos, and with a large number of young people entering the job market because of a baby boomlet in Europe in the early 1960s, the results are massive unemployment -- over 10 percent and still rising in practically every country -- and budget deficits because of greater and greater unemployment and welfare expenditures. [REDACTED]

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Even today, with their economies finally appearing to be moving onto positive growth paths, practically all of that growth is coming from an export boom due to US economic growth and the competitive edge the Europeans have gained because of the strong dollar. Most Europeans see such growth as temporary, limited to a few sectors, and encouraging protectionist pressures in the United States. Perhaps most important, they fear the potential consequences of a massive trade turnaround if the dollar falls and US products once again can compete in Europe. [REDACTED]

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Most West European leaders would agree privately that their economic problems are due largely to domestic market inflexibility -- that is, to factors such as administrative bottlenecks, conservative financial systems, risk-averting management philosophies, and pervasive job guarantee programs. However, politics and human nature will almost certainly combine to encourage a search for outside forces to blame. The primary target is likely to be high US interest rates, which some leaders -- probably led by the French -- will argue are sucking capital, and thus jobs, out of Europe. [REDACTED]

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The Europeans are also likely to complain about tight US research and technology policies -- especially those related to defense and to COCOM-controlled products but increasingly to civilian industries as well -- that they suspect are designed to prevent West European access to new technologies and thus ensure continued US competitive superiority. [REDACTED]

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UNITED KINGDOM

The United Kingdom is into its fourth year of a moderate economic recovery. London has adhered to tight fiscal and monetary policies to wrestle inflation down to below 5 percent and reduce the budget deficit to 3.25 percent of GDP. Thatcher believes that selective tax cuts, market liberalization, and the reduction of government involvement in the economy have been the key to Britain's recovery. She is especially proud of her program of denationalizing industry and may urge other countries to adopt similar policies to reduce structural rigidities in their own economies. Thatcher also contends that an essential ingredient to long-term growth is reducing the power of labor unions in Britain and sees her recent victory over the coal miners as a step in that direction.

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Nevertheless, serious economic problems remain. The recovery has not been fast enough to arrest unemployment, which is now over 13 percent and still rising. Moreover, Thatcher is worried that high British interest rates -- raised a total of four and a half points in January to defend sterling against a strong dollar -- could worsen the unemployment situation. She is likely to join other leaders in criticizing the US budget deficit at the Summit, especially if the dollar remains strong on international markets. Even though the Prime Minister does not believe that exchange intervention can alter underlying market trends, she may push for renewed agreement on coordinated intervention by central banks on certain occasions.

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WEST GERMANY

The Summit convenes in Bonn a little more than a week before an important election for the leadership of West Germany's most populous state, and Chancellor Kohl hopes to boost his party's chances by presenting himself as host and his Christian Democratic-led government in a positive light. For now, the Chancellor's position is secure, but he continues to suffer from accusations of indecisive and often confusing leadership. While high unemployment and the US dollar and budget deficit remain concerns in Bonn, Kohl will look to the Summit primarily to produce action on a new round of trade negotiations and to discuss the need for environmental protection. The rapidly worsening condition of German forests is producing negative political fallout for all the major parties. Kohl also hopes that the Summit will produce a display of Allied unity that will carry over into the following week as Europe celebrates the fortieth anniversary of VE-Day. He is especially anxious that this will demonstrate his country's unquestioned acceptance as a member of the Western community of democratic states.

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FRANCE

President Mitterrand has been in office for four years, but his seven-year term does not expire until 1988. After some early economic policy mistakes, which included short-run stimulation of the economy and nationalization of most banks and several large firms, Mitterrand has reversed course and implemented restrictive fiscal and monetary policies aimed at correcting some of the fundamental problems of the economy. Inflation has been reduced from near 14 percent in 1982 to less than 7 percent last year; during the same period, the current account deficit has been cut from \$12 billion to near balance, in part due to increased exports to the United States. Unemployment, however, has risen throughout Mitterrand's term and now stands near a postwar record of 10.5 percent. It is the major economic problem facing the government and could lead to significant reduction in Socialist representation in the National Assembly when elections are held next spring.

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Mitterrand generally has been impressed by American economic flexibility and dynamism and is seeking ways to apply the virtues of the American system. So far, however, little tangible has been accomplished. For example, although most government officials, industrialists, and leaders of the major democratic unions agree that labor practices need to become more flexible, the powerful Communist-dominated trade union has torpedoed efforts in this direction. As a result, the job-trimming necessary in loss-making firms like Renault has not been accomplished. The government has been hesitant to mandate increased flexibility and may not do so before next year's election.

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Mitterrand's major worry coming into the Summit is that France's fragile economic recovery could be threatened by high US interest rates and the strength of the dollar. This concern is balanced, however, by realization that a sudden decline of the dollar could seriously upset French exports. Mitterrand is likely to press you to reduce interest rates and may push for international monetary reform measures to stabilize the dollar. In the past, French officials have threatened to block US efforts to begin a new trade round until monetary reforms have been agreed. This danger remains, but Mitterrand is generally more practical and statesmanlike than his outspoken advisers.

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Jacques Delors--President of the EC Commision

Jacques Delors, Mitterrand's former Finance Minister, will attend this year's economic summit as the newly appointed President of the European Community's Commission. Delors generally tries to avoid diplomatic ceremony and brought his reputation as a candid pragmatist to the Commission when he arrived in January. He is considered to be more self-confident, forceful, and reflective than his predecessor, Gaston Thorn of Luxembourg. [REDACTED] 25X1

The Commission President traditionally takes a back seat during summit discussions, and we believe Delors generally will maintain this low profile. According to diplomatic reports, Delors believes the US and Western Europe must work together more closely to minimize transatlantic economic frictions. Delors has not hesitated to criticize sharply US economic policies, especially when asked for his personal opinions. Speaking to a European group in early March, he warned of a major clash between the United States and Western Europe over international trade and the handling of the Third World debt situation. [REDACTED] 25X1

At the summit, Delors is likely to be most concerned by Washington's determination to launch a new multilateral trade round in 1986. According to diplomatic reports, Delors believes such an initiative could detract from his efforts to liberalize trade within the Common Market. He may also prefer to postpone the new round until 1987 at the earliest--after Spain and Portugal enter the European Community. [REDACTED] 25X1

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[redacted]

Strasbourg and the European Parliament

Strasbourg--the capital of the French province of Alsace--is located about 250 miles east of Paris, virtually overlooking the Rhine River and the border with West Germany. Founded by the Romans in the First Century, B.C., Strasbourg was a medieval hub of learning and commerce. Over the years, the province of Alsace has been bitterly contested by Germany and France and, since 1871, has changed hands six times. It was fitting, therefore, that following World War II the countries of the European Community chose Strasbourg to be the meeting place for the European Parliament--the institution that perhaps best epitomizes the ideal of a democratic and united Europe. [redacted]

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The European Parliament--one of the principal bodies of the European Community--is the only European-wide institution whose members are directly and popularly elected. Its 434 members meet for one week each month at the Palais de L'Europe--a starkly modern structure that stands in marked contrast to the 17th Century rooftops of the old city. Members of the European Parliament, who serve for five years, sit according to party preference, not by nationality. Socialist members form the largest single party group in the current parliament--elected last June--but a coalition of center-right parties firmly controls the body. [redacted]

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The President of the European Parliament--Pierre Pflimlin--is a widely respected French Christian Democrat, former Prime Minister of France, and ex-mayor of Strasbourg. The 78-year-old Pflimlin was a close friend and supporter of Robert Schuman, one of the founding fathers of the European Community, and is committed to Schuman's dream of a united Europe. [redacted]

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Two other bodies of the European Community, the Commission and the Council, are required by treaty to consult the European Parliament before adopting EC-wide policies. Parliament's advice is not binding, however, except on certain budget questions. Despite its limited watchdog function, the European Parliament has wide rein to discuss issues of common interest--ranging from consumer protection to foreign policy--and make recommendations to the EC members. Direct representation, plus the authority to identify European-wide concerns, establishes the European Parliament as the voice of the people in the European Community. [redacted]

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ITALY

Socialist Prime Minister Bettino Craxi has held his five-party coalition together now for over 18 months -- nearly double the average life-span of Italy's 40 previous postwar governments. The Summit must seem like a heaven-sent opportunity to Craxi, who faces important nationwide local elections on 12 May; he probably will use it to enhance his image as an international statesman and to cast some of the blame for Italy's economic problems on high US interest rates and the strong dollar. Economic issues will play an important role in the elections. The Communists -- hoping to firm up their tentative claim to being the country's largest party -- are charging economic mismanagement in the wake of the record 10.4-percent unemployment rate, continuing inflation, and a budget deficit that reached 16 percent of GDP last year. Unless the Socialists do well in the elections, Craxi is likely to come under fire from the left wing of his party, who prefer an alliance with the Communists rather than with the Christian Democrats -- who appear to be slipping after 40 years of ruling the roost. With an eye on the elections, Craxi will take full advantage of Italy's current six-month presidency of the EC Council -- the Community body made up of representatives from the ten member states -- to issue pronouncements on issues such as East-West relations, the Middle East, and Central and South America.

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SUMMIT VIDEO

JAPAN

Prime Minister Yasuhiro Nakasone comes to the Summit facing political uncertainty at home. His major ally in the ruling Liberal Democratic Party, former Prime Minister Tanaka, suffered a stroke in late February. Nakasone's position as Prime Minister is not in immediate danger, but if Tanaka's illness proves to be lengthy, pressure will build for a change in leadership of his faction--by far the largest in the party. This, in turn, could trigger a major change in the ranks of the party leadership.

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In his private meetings with you in Bonn, Nakasone will probably reaffirm his support for the strategic defense initiative and may offer Japanese participation in exploring related new technology. He may also stress that by refusing to cave in to opposition to increased defense spending, both within and outside the LDP, he has laid the groundwork for a greater Japanese commitment to defense in the Pacific. He may add that the military budget could break the limit of one percent of GNP as early as this summer. He will probably review progress in opening markets in the four sectors--telecommunications, electronics, forestry products, and pharmaceuticals and medical equipment--that you agreed upon at your meeting in Los Angeles in January. Although we believe Nakasone is sincere in his efforts to increase foreign access to Japanese markets, he is facing domestic opposition, particularly to cuts in plywood tariffs.

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Nakasone's main objective for the Bonn Summit is to once again portray himself as an international leader. He will also likely call for a new round of multilateral trade negotiations to reduce global protectionism. In discussions of future worldwide economic growth, Nakasone will emphasize that Japanese GNP grew in 1984 at its highest rate since the 1970s. If there is debate on the high dollar issue, Nakasone will most likely side with Western Europe, but will be low key in his criticism of US policy. In view of growing complaints from the Summit countries over closed Japanese markets, Nakasone hopes to avoid discussing trade issues in Bonn. If pressed, however, he will probably point to recent successes, such as the liberalization of the financial market, and claim that Tokyo is moving as quickly as possible in other sectors.

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CANADA

Canadian Prime Minister Brian Mulroney almost certainly sees the Bonn Summit as his first major opportunity to play on the world stage. He is aware -- due to former Prime Minister Trudeau's example -- of the Summit's potential as a vehicle for impressing Canadian voters, and with his government having difficulty implementing its domestic economic program, he probably sees the need to perform especially well in Bonn. Mulroney has moved speedily to build closer ties with the United States; at the same time, however, he may use the Summit to establish Canadian positions on some economic issues that differ from Washington's. In particular, Mulroney is likely to join other Summit countries in criticizing the strength of the US dollar. The dollar is of special concern because Canada imports more from the United States than does any other Summit country. As a result, Ottawa claims that the strong US dollar is causing inflationary pressures in Canada and is drawing excessive Canadian investment into the United States.

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Mulroney, however, will not be the wild card that Trudeau was -- especially on arms control and disarmament matters -- and almost certainly will work for consensus on major issues. For Canada, trade is perhaps the most important issue. Nearly one-third of Canada's GNP is tied to exports (compared with about one-tenth for the US); moreover, exports -- three-fourths of which go to the United States -- are the primary locomotive in Canada's current recovery. As a result, Mulroney is especially eager to promote Summit unanimity on the need for a new multilateral trade round and on combating protectionism.

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Although environmental concerns remain an important political issue in Canada, the Prime Minister is not likely to push as hard on this subject as did his predecessor. Mulroney apparently would prefer to keep discussions of acid rain on a bilateral basis with the United States. Nonetheless, he cannot afford to be publicly perceived as doing less than West German Chancellor Kohl and will follow Kohl's lead when the Chancellor initiates the discussion of environmental issues.

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PORTUGAL

Portugal, one of the poorest countries in Western Europe, is still settling into its relatively new democracy. Voters support the democratic system that grew out of the revolution 11 years ago, but are dissatisfied with the performance of the politicians who alternate in and out of office. Portugal's present government is a Socialist-led coalition that strongly supports NATO and the United States. Policy differences and the upcoming presidential election in December, however, are increasing tensions among the governing Socialists and Social Democrats. President Eanes, a military man who is independent of the established parties, cannot succeed himself and Prime Minister Soares would like to replace him. His Social Democratic Party coalition partners, however, want to run their own candidate, which will likely break the coalition.

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President Eanes still harbors political ambitions and is flirting with supporters of his who recently launched a new political party to compete in the election. The party will need his active support to get off the ground. To date, Eanes has not decided how much of his prestige he wants to risk in that venture. A few of the party's leaders talk about the need for "dialogue" with Portugal's Stalinist Communist Party, a potentially worrisome development.

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Despite the strains within the coalition, the government has pursued tough and unpopular austerity measures that cut Portugal's balance of payments deficit from \$3.2 billion in 1982 to \$600 million in 1984. These improvements have come at the expense of the workers, whose already low real wages were further reduced by about 19 percent during the past two years. The government is pressing efforts to join the European Community in hopes that membership will promote economic development. Initially, however, membership will be a major jolt for Portugal's largely small-scale and inefficient industry and agriculture.

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SPAIN

Socialist Prime Minister Felipe Gonzalez faces some of the toughest problems of any West European leader. Despite his Socialist background, Gonzalez has bet on conservative economic policies to lay the foundation for lasting economic growth, but unemployment has climbed from 17 to 22 percent since he took office in December 1982. On the brighter side, Gonzalez faces weak and divided opponents, and opinion polls make him a strong favorite to win the next election which must be held by December 1986. Feuding between pro-Moscow and Eurocommunist factions has discredited the Communists, and divisions over personalities and policies have prevented centrist and conservative politicians from mounting an effective challenge. The coming year will be decisive for his efforts to keep Spain in NATO. Gonzalez will either have to back out of his promise to hold a referendum on NATO by April of next year or mount an uphill campaign to reverse the current 2:1 opposition to the Alliance. Either course will be difficult personally and cost him politically. Membership in the European Community probably would help reinforce Spain's ties to NATO, but still unresolved differences over fishing and agriculture and lack of a firm EC negotiating position may push back the planned entry date of 1 January 1986.

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The King, Juan Carlos, also plays an important role. He is largely responsible for putting Spain on the road to democracy after the death of Franco, and he intervened dramatically in February 1981 to put down a coup attempt by restive military officers. Since Gonzalez's election, the King has acted as a largely ceremonial chief of state. Juan Carlos, however, remains a booster of the United States and NATO, and advises Gonzalez from time to time on foreign policy. He also helps him occasionally in his dealings with opposition politicians.

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